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March 14, 2006

AGENDA ITEM 6

TO: MEMBERS OF THE HEALTH BENEFITS COMMITTEE

I. SUBJECT: Long-Term Care Program: Adoption of Annual Valuation

II. PROGRAM: Long-Term Care

III. RECOMMENDATION: Staff recommends that the Board adopt the Long-Term Care Program 2005 Valuation Report

IV. ANALYSIS and DISCUSSION:

Annual Actuarial Valuation as of June 30, 2005

Staff provided a summary of the results of the Long-Term Care Program (Program) 2005 Valuation Report and program recommendations at the February 2006 meeting of the Health Benefits Committee. Because of the deterioration of the Program's financial conditions, staff delayed asking the Board to adopt the 2005 Valuation Report in order to ensure that members of the Long-Term Care Advisory Committee and other interested constituents had sufficient time to review the contents and conclusions of the Report. The Report has been presented to the Long-Term Care Advisory Committee and other constituents.

Summary of Valuation Report

The CalPERS Long-Term Care program (Program) 2005 actuarial valuation, Attachment 1, was completed by United Health Actuarial Services, Inc. The valuation included a baseline valuation that incorporated assumptions based on an investment earnings rate of 7.79% (as reflected in the analysis prepared by Wilshire Consulting when the revised asset allocation was adopted by the Board in March 2005), increased expenses, revised claim costs, and higher premiums rates resulting from the 2003 premium rate increase. Further projections were included that incorporated alternative assumptions to reflect additional adverse deviations to the Program's current assumptions. The results of the baseline scenario, Scenario A(3) on page 8 of the 2005 valuation report, show a deficit of 39.4 percent or $812.8 million. The 2004 valuation, completed by Long Term Care Group, Inc.'s (LTCG) actuaries, indicated a projected surplus of $1.3 million, or approximately 0.1% of the present value of future premiums.

The key variables that account for the deterioration of the financial position of the Program compared to the 2004 valuation are:

→ The 2005 valuation updated the detailed morbidity study initially completed in 2004 using actual Program experience through 6/10/05.

→ The 2005 valuation developed revised ultimate claims costs assumptions by credibility-weighting adjusted actual program claims costs against assumed ultimate claims costs.

→ Claims payment distributions were revised to reflect emerging experience and were developed to be consistent with current liability/reserve levels.

→ Adjustments in amounts associated with individuals already on claim have been revised.

The cumulative effect of these changes is summarized in the valuation analysis:

These revisions collectively result in a significant increase in projected future claims for the Program as compared to the 2004 valuation. Please note that if experience continues to emerge in a manner consistent with how experience has emerged to date, valuation results will continue to deteriorate.

What Is the Key Consideration for the Long-Term Care Program?

The principle objective of the Program is to ensure there will be sufficient funding to pay promised benefits − both current and in the future. This requires annual evaluation to ensure the actuarial assumptions continue to be reflective of the Program's actual experience. The key valuation assumptions wherein the Program's experience may deviate adversely are:

- Lapse rates—voluntary terminations of coverage
- Investment earnings rate—investment returns (currently 7.0%)
- Claim incidence—reflects the likelihood of going into claim
- Claim continuance, severity—reflects the probability of remaining on claim
- Mortality rates–death rate
- Expenses—administrative costs
- Investment volatility--the volatility of an investment is measured by the standard deviation of its rate of return.

In completing the 2004 valuation, LTCG actuaries were specifically asked to validate prior year assumptions, in particular focusing on claims experience and resulting costs to the Program. Due to time constraints, the 2004 valuation was not able to include the necessary detailed analysis but did identify potential difficulties and recommended further detailed analysis of the Program's actual claims experience and incorporation of that experience as credibility increased. While the 2004 valuation indicated a small surplus, the overall fiscal condition of the program was subject to considerable risk particularly as claims experience and morbidity/mortality were adjusted to better reflect actual Program experience.

The 2004 valuation did provide projections for adverse deviations to the Program's assumptions. Specifically, two items were identified that had a significant impact on the estimated valuation and were consistent with items identified by the Board's consulting auditors, Deloitte and Touche, in their commentary on the Long-Term Care Program valuation. The two changes were to extend the projection period to 50 years from the 40 years used in prior valuations and to reduce the morbidity/mortality improvement by 50% to better reflect actual Program experience. The impact of these two additional items influence the claims experience and reduced the estimated surplus by 9.3% ($210.6M) and 11.2% ($253.6M) respectively. When United Health Services was engaged to complete the 2005 valuation these issues were highlighted for consideration as they continue to impact the long term financial viability of the Program.

Recommendations

Staff recommends that the Board adopt the Long-Term Care Program 2005 Valuation Report as submitted and direct staff to continue to work with the Long-Term Care Advisory Committee and the Program's consulting actuaries, United Health Actuarial Services, Inc., to continue to develop mitigation strategies. Staff will provide the Health Benefits Committee with recommended mitigation actions at the April meeting to ensure timely implementation while also ensuring that the Board and its constituencies fully understand the options and implications of all proposed mitigation actions.

V. STRATEGIC PLAN:

This item is not a specific product of the Strategic Plan. It is brought to the Committee because of a request by the Board to report annually.

VI. RESULTS/COSTS:

The number of members who applied for the CalPERS Long-Term Care Program clearly indicates the Board's responsiveness to satisfying members' demands and needs for financial security associated with long-term care coverage.

Staff is available to answer questions.

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Richard J. Krolak, Chief
Office of Health Plan Administration

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Terri Westbrook
Assistant Executive Officer
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Attachment